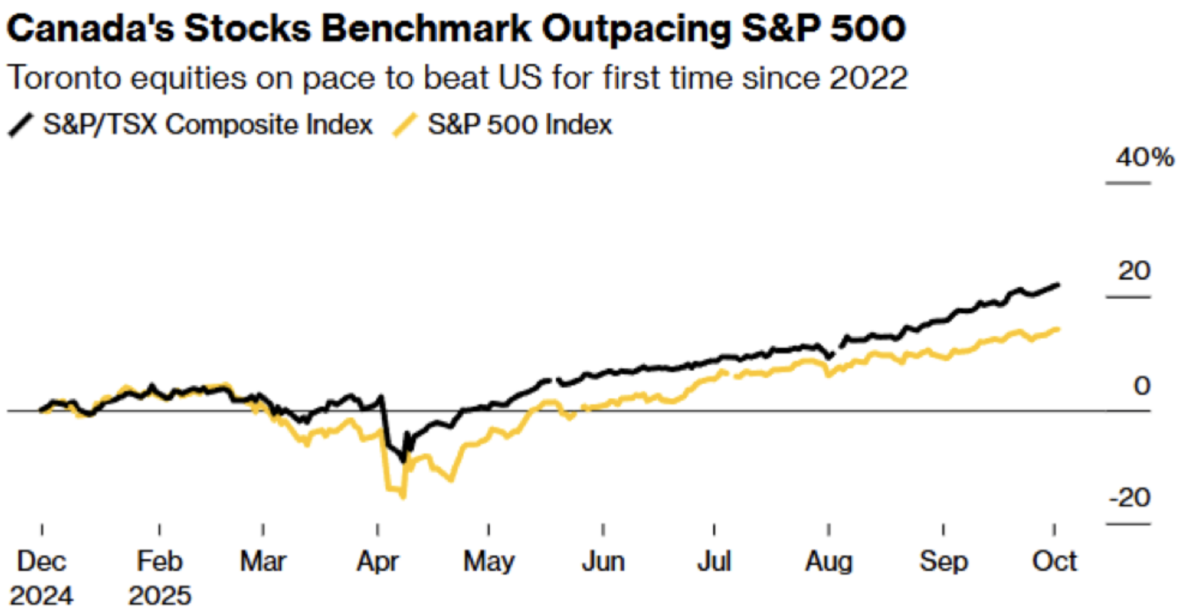
September Market Commentary | Leadership Narrows as Policy Unfolds

Returns in September contributed to a positive third quarter for North American markets. The S&P 500 rose 3.6% (total return in U.S. dollars) in September, +8.1% for Q3 2025, and +14.8% year-to-date. Canadian stocks performed even better. The S&P/TSX gained 5.4% last month, delivering +12.5% for the quarter and +24.0% so far this year (total return in Canadian dollars).

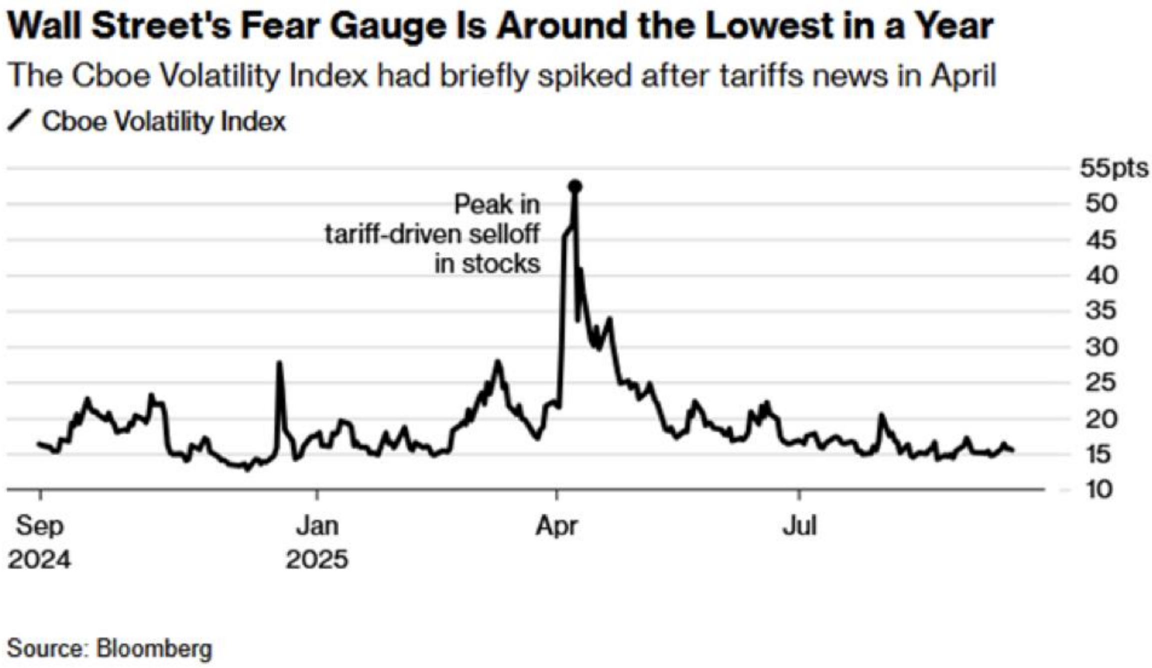
According to Bloomberg, Canadian stocks are on pace to outperform their U.S. counterparts for the first time since 2022. While the rally in gold and gold-mining stocks has been a key driver, BMO Capital Markets noted that as of September 24, even excluding the materials sector, the S&P/TSX would still be expected to outperform the S&P 500 in 2025.



Source: Bloomberg
Data is normalized with percentage appreciation as of December 31, 2024.

Gold strength draws attention amid equity markets.

Gold’s outperformance has raised eyebrows. The metal typically rallies when investors are nervous, which seems at odds with equity markets at record highs. The CBOE Volatility Index (VIX) remains near year-lows, but single-stock volatility has stayed elevated since 2023.



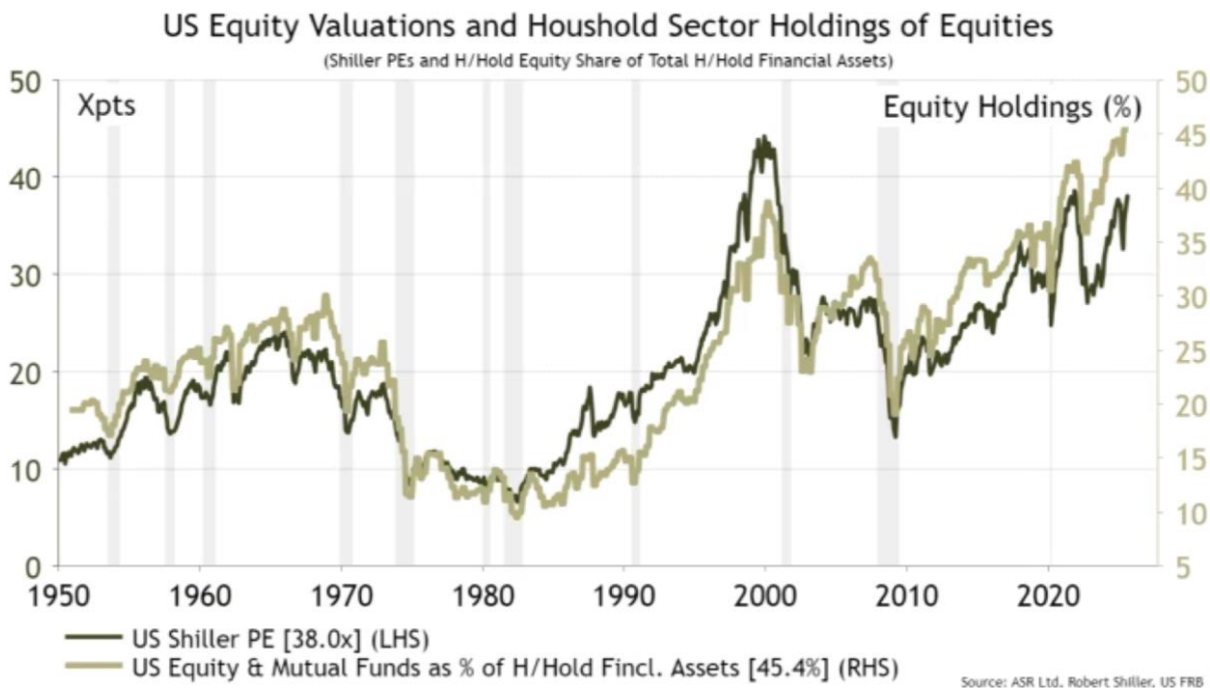
Despite stronger equity returns, traders remain cautious. Roughly $2.3 billion exited the Direxion Daily Semiconductor Bull 3x ETF in September, and the American Association of Individual Investors reported seven consecutive weeks of bearish sentiment ending mid-month. Although sentiment has improved since, the combination of gold strength and risk aversion is notable.

Cash levels suggest optimism may be stretched.

While the rally in gold and the deterioration in sentiment may be unsettling, some strategists are taking some comfort in knowing that investors are holding substantial cash reserves. When deployed, this capital could help drive stock prices higher.

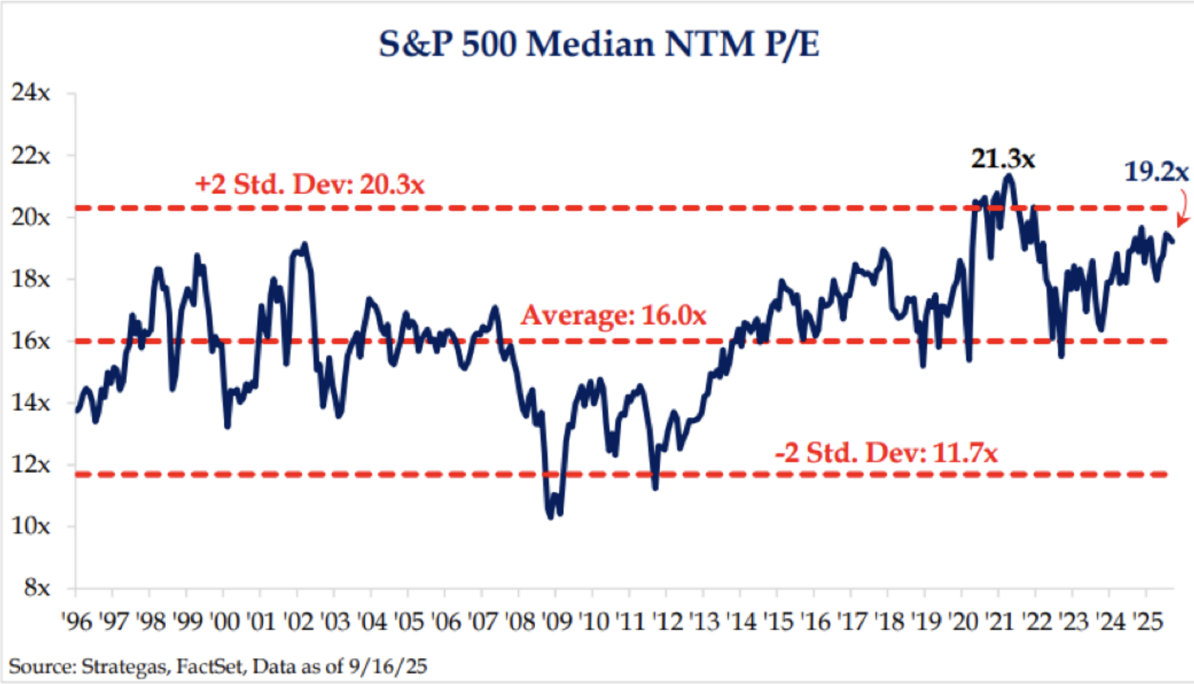
However, while assets in money-market funds are at record levels, cash allocations within individual investment portfolios remain low at just 3.9%. Bank of America's strategy team views this as a bearish indicator and even a potential sell signal.

Ian Harnett of Absolute Strategy Research notes that U.S. equity valuations and the share of household financial assets held in equities have been rising together. This suggests that U.S. stocks may now be both overvalued and overowned.

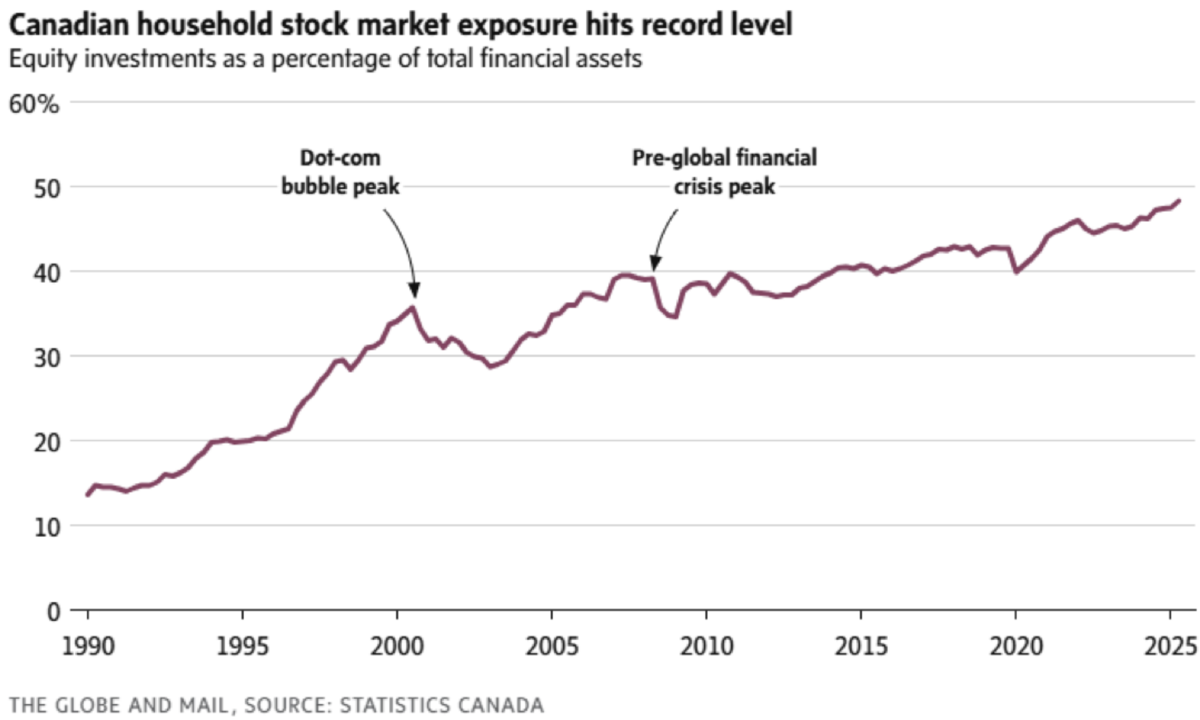


Canadian stocks are also expensive.

Canadian stocks are also expensive, though to a lesser degree than their U.S. counterparts. Strategas estimates the S&P 500's 12-month forward price-to-earnings multiple at 19.2 times, nearly two standard deviations above its long-term average. In comparison, Scotiabank calculates the S&P/TSX 12-month forward multiple at roughly one standard deviation above normal.



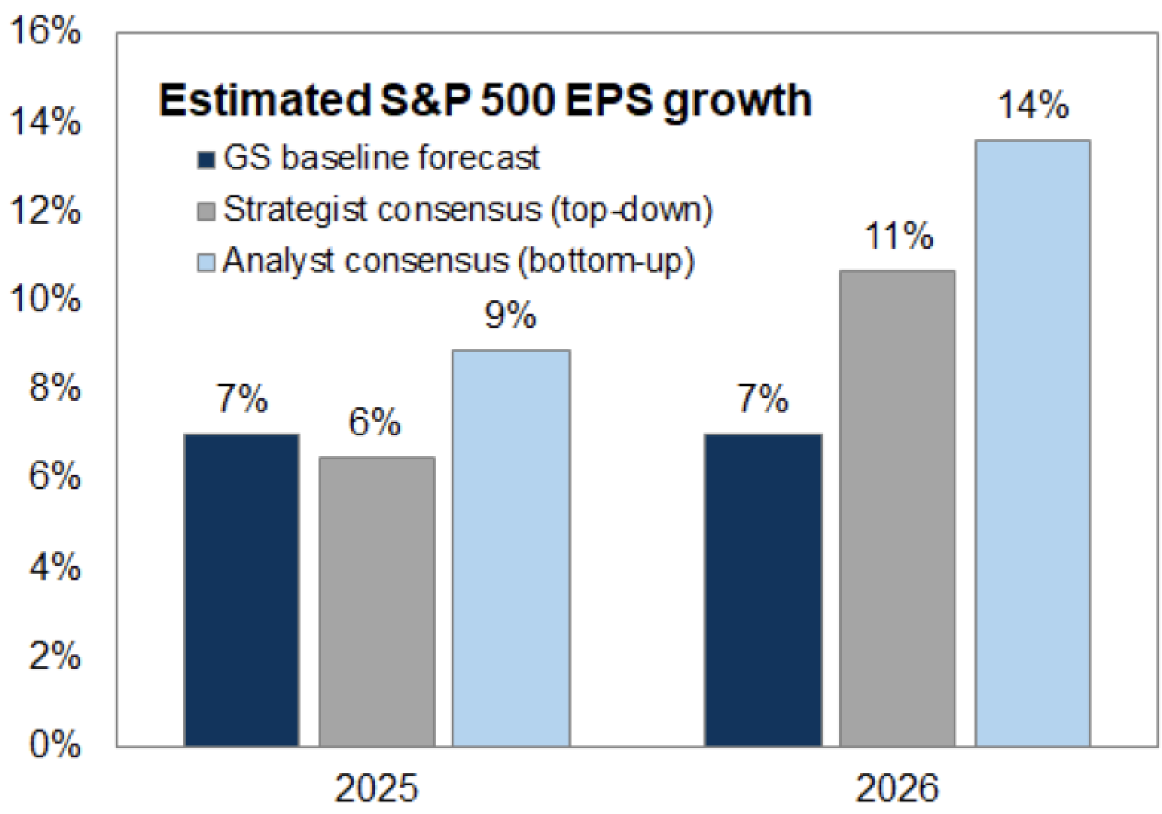
According to The Globe and Mail, Canadian household exposure to equities is also at record levels. However, Strategas notes that Canada remains underowned from a global ETF perspective, offering some relative support.



Earnings continue to outpace expectations.

Looking ahead, the trajectory of earnings growth and interest rates remain an important focus. Bloomberg Intelligence reports that S&P 500 earnings guidance momentum reached its highest level in a year, with bottom-up analyst forecasts calling for earnings growth of 9% in 2025 and 14% in 2026.

Exhibit 3: GS vs. consensus S&P 500 EPS forecasts



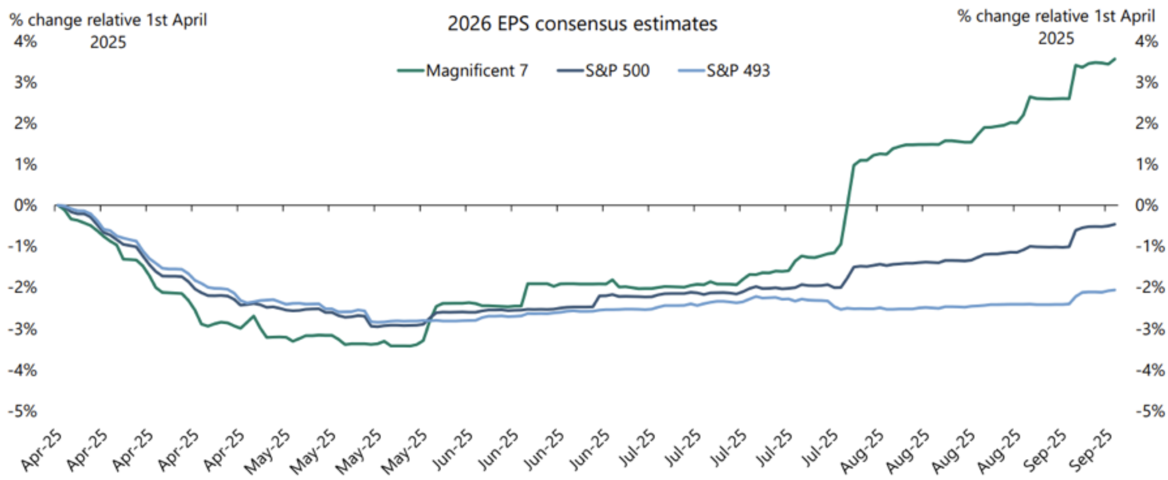
Source: FactSet, Bloomberg, Goldman Sachs Global Investment Research

Goldman Sachs and other top-down strategists are more cautious. Goldman projects earnings per share growth of 7% in both 2025 and 2026, while broader consensus estimates stand at 6% and 11%, respectively.

Apollo notes that since April 1, all upward revisions to 2026 earnings have come from the Magnificent 7, while the remaining 493 stocks in the S&P 500 have seen earnings forecasts decline by about 2%.

APOLLO

It is all about the Mag 7: No upward revisions to 2026 EPS for the S&P 493



Sources: Bloomberg, Apollo Chief Economist

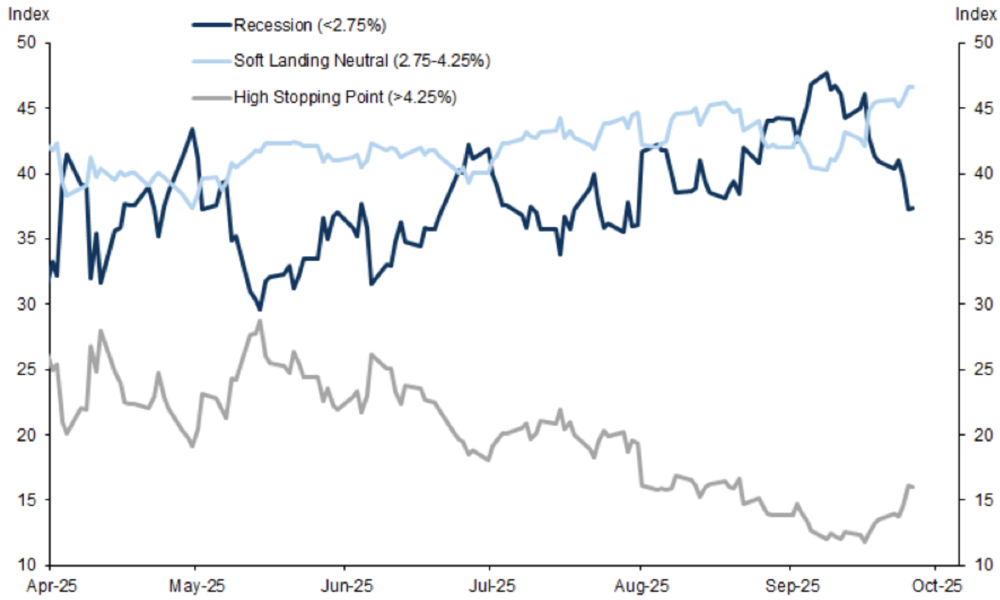
This presents both an opportunity and a risk. The opportunity lies in earnings growth broadening beyond the largest companies. The risk is that this does not occur, and the Magnificent 7 begin to lose momentum.

The economy seems poised for a turning point.

The economy appears to be at a crossroads, poised to either slow and possibly contract or reaccelerate and run hot. A recession would weigh on earnings growth, while an overheated economy could drive inflation higher, push interest rates up, and compress valuations. Historically, favourable outcomes for investors have occurred in the middle ground between these two extremes.

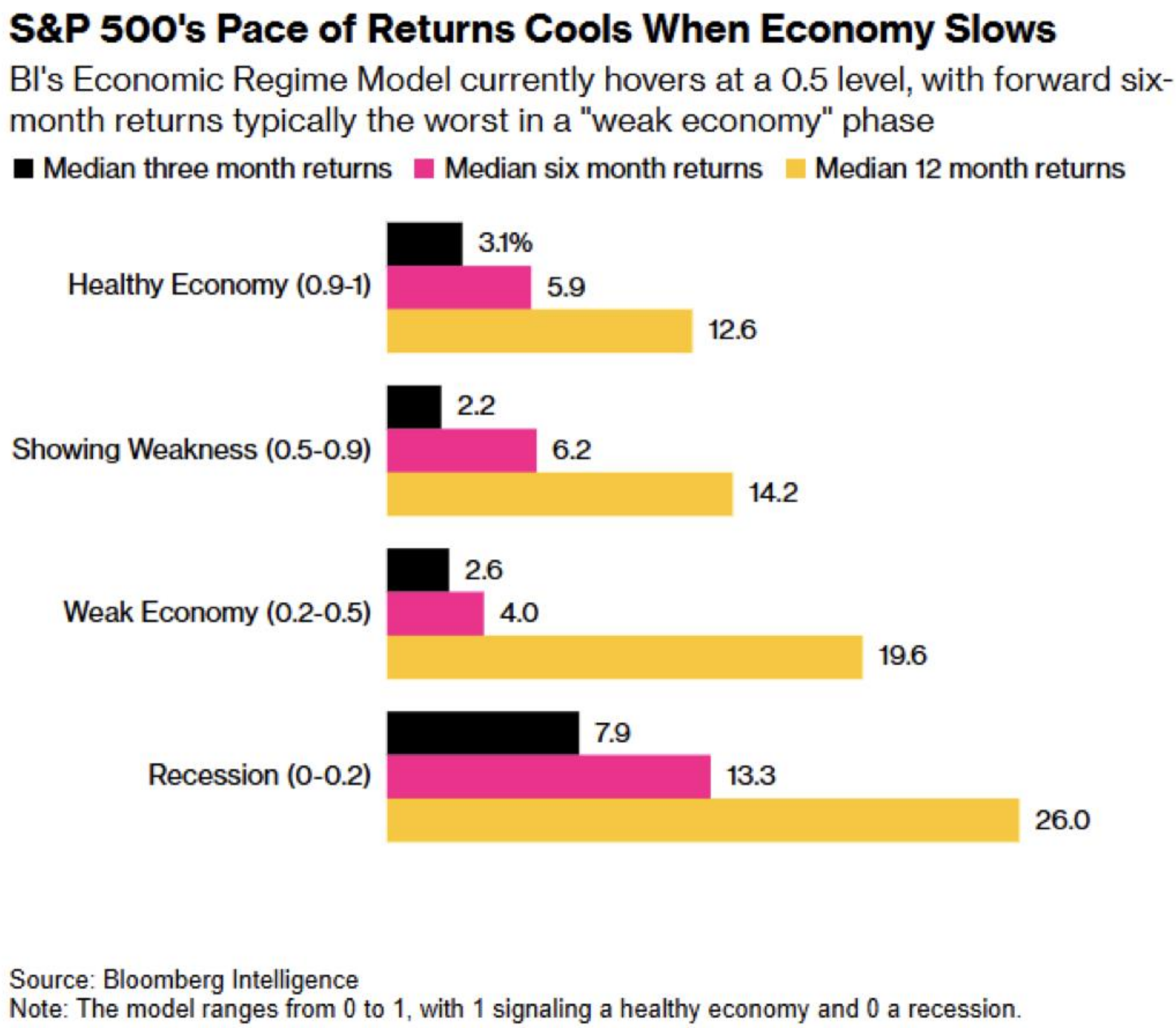
Markets have recently lowered the probability of additional Federal Reserve rate hikes, with a “soft landing” now seen as the most likely scenario. In a non-recessionary environment, rate cuts have historically been supportive for equities.

Exhibit 6: The market has lowered the probability of Fed hikes and raised the probability of "soft landing"



Source: Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

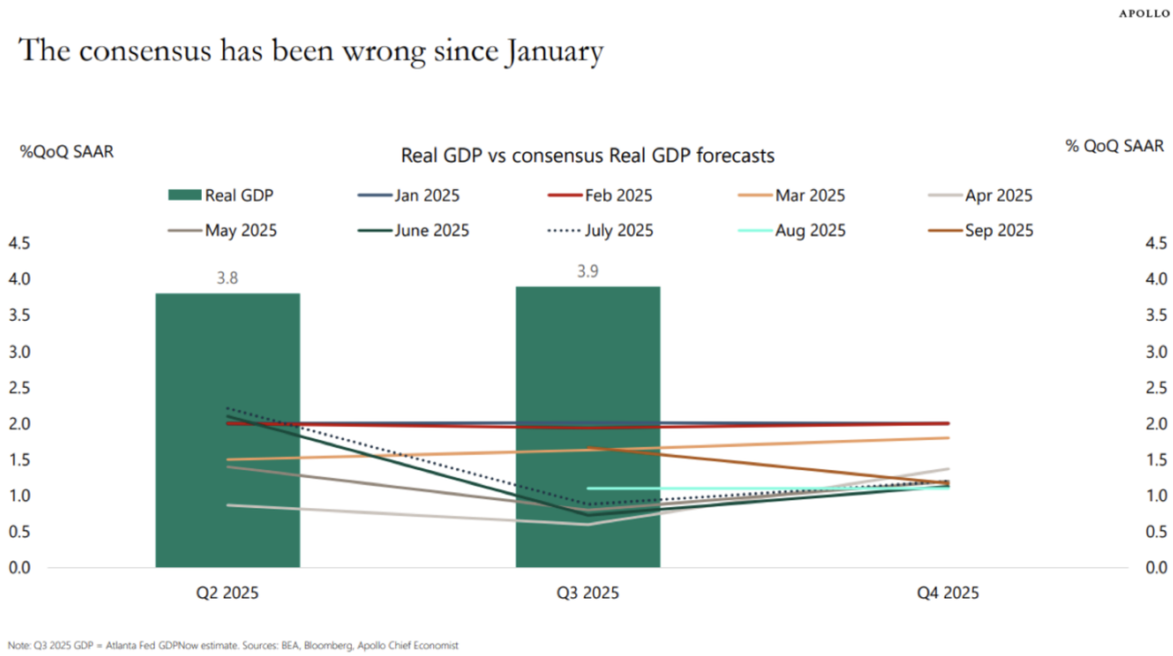
Still, the distinction between recessionary and non-recessionary conditions is relatively narrow, and the market implications can be significant. Bloomberg Intelligence notes that the economy is currently in a rare in-between phase, which has historically produced muted returns of roughly 4% over the following six months.



U.S. growth continues to exceed expectations.

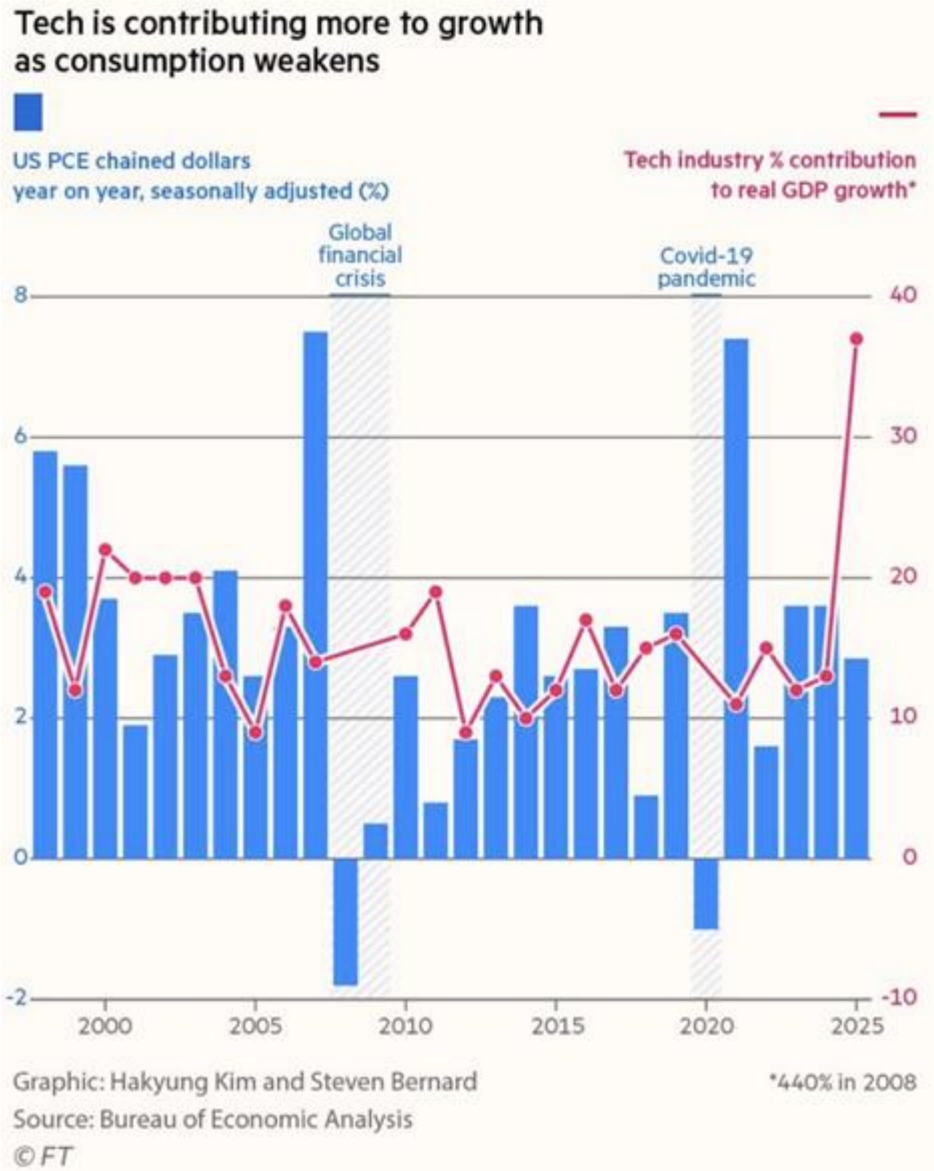
This is not what the market is currently pricing in, and with good reason. The U.S. economy expanded at its fastest pace in nearly two years during the second quarter of 2025. Goldman Sachs notes that economic data has continued to surprise to the upside over the past month.

As of October 7, Atlanta Fed's GDPNow model forecasts third-quarter GDP to grow by 3.8%, prompting many to ask whether the U.S. economy is stronger than previously thought. Apollo believes the consensus has been wrong since January, consistently underestimating the strength of U.S. growth.

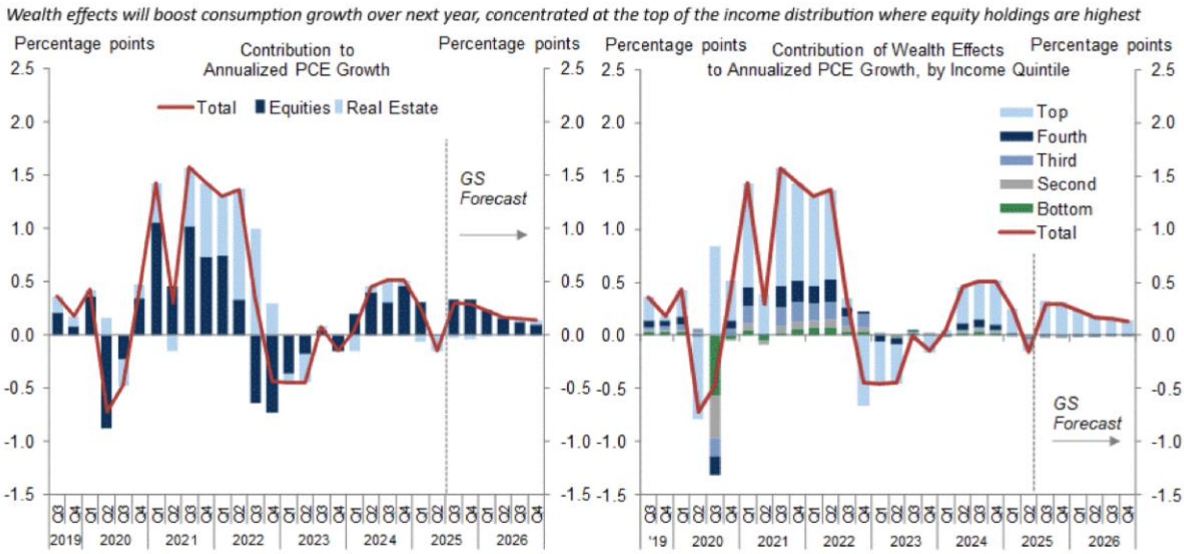


Technology spending fuels resilience.

Some of the recent economic strength may be driven by technology investment and capital spending related to building infrastructure for artificial intelligence. In fact, technology is contributing more to U.S. growth than consumer spending, with Deutsche Bank claiming the economy could have been close to recession without this tech-driven boost.

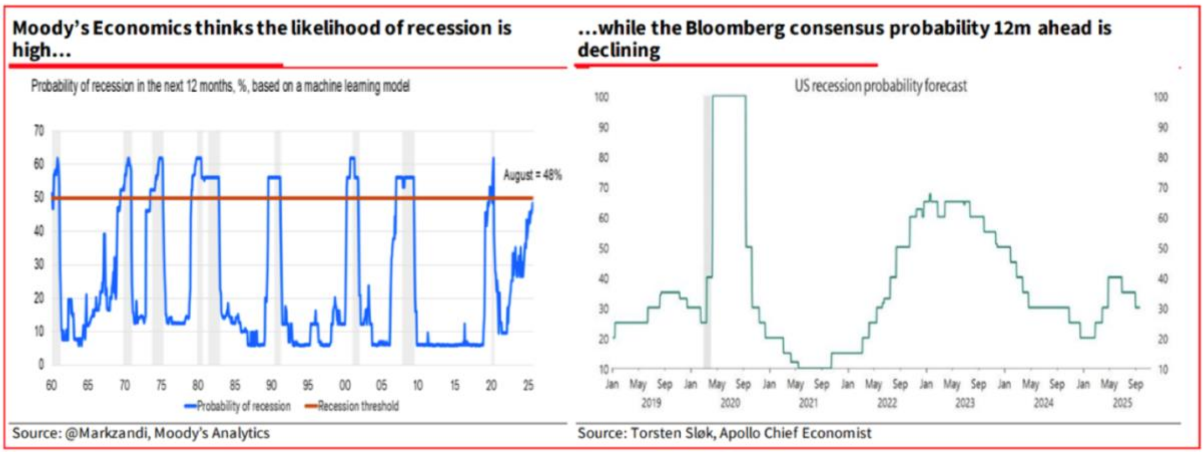


Recent market performance is also supporting growth through the wealth effect, as rising equity values increase consumer spending. Goldman Sachs notes that this dynamic is concentrated among higher-income households, where equity ownership is most prevalent. As a result, a market correction could have a larger negative impact on the broader economy than many expect.



Source: Goldman Sachs

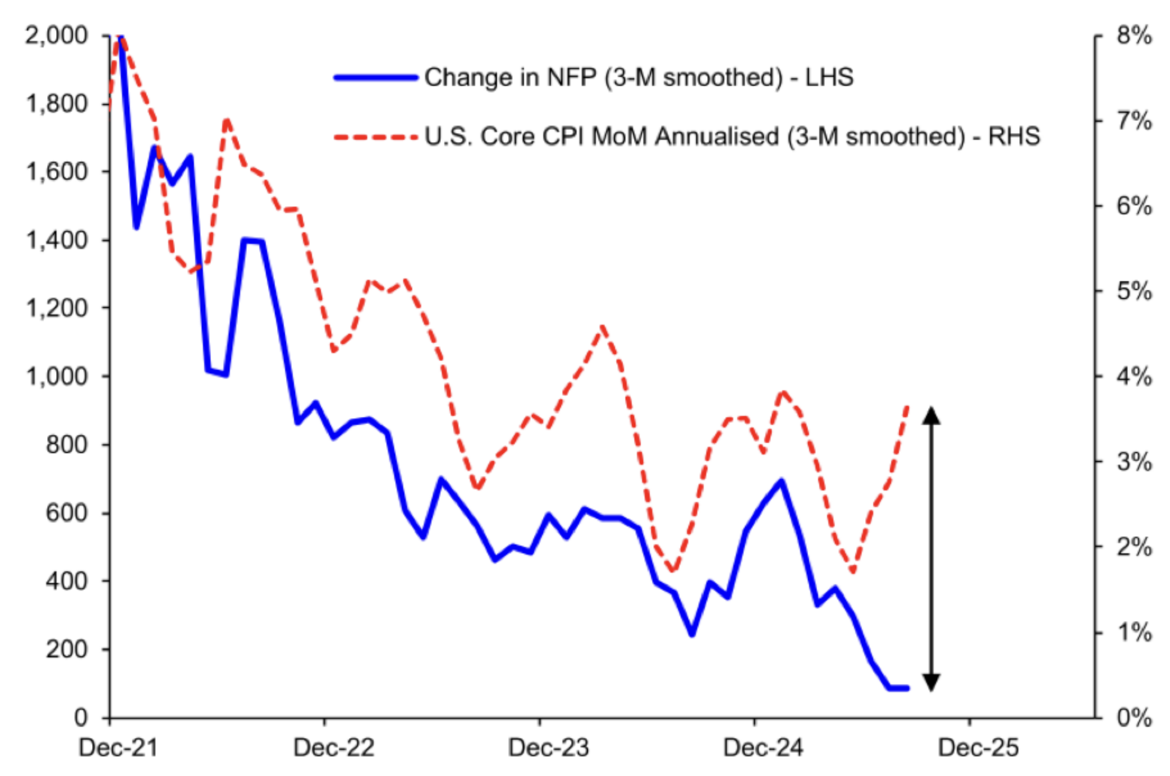
Technology spending and the wealth effect may help explain the growing disconnect between strong GDP figures and a weakening job market. However, this also makes forecasting economic growth more difficult. Moody's Analytics believes the risk of recession is high and rising, while Apollo sees the Bloomberg consensus probability of a recession over the next year moving lower.



The Fed cuts rates but keeps options open.

What is the Federal Reserve to do? Growth remains solid and inflation elevated, but the job market is showing signs of strain. Policymakers cut rates by 25 basis points to a range of 4.0% to 4.25%, with Bloomberg reporting that the downside risks to employment outweighed the upside risks to inflation.

Exhibit 1 - Growing Divergence Between Fed's Dual Mandate



Source: Scotiabank GBM Portfolio Strategy, Bloomberg.

While the cut was widely expected, the path forward is uncertain. A rate hike is unlikely, but the pace and extent of future cuts remain open to debate. The Wall Street Journal notes that the Fed projects rates at 3.4% by the end of 2026, while markets expect them to fall below 3%. With U.S. data still holding up, financial conditions relatively easy, and new fiscal stimulus expected next year, it is unclear whether lower rates are warranted.

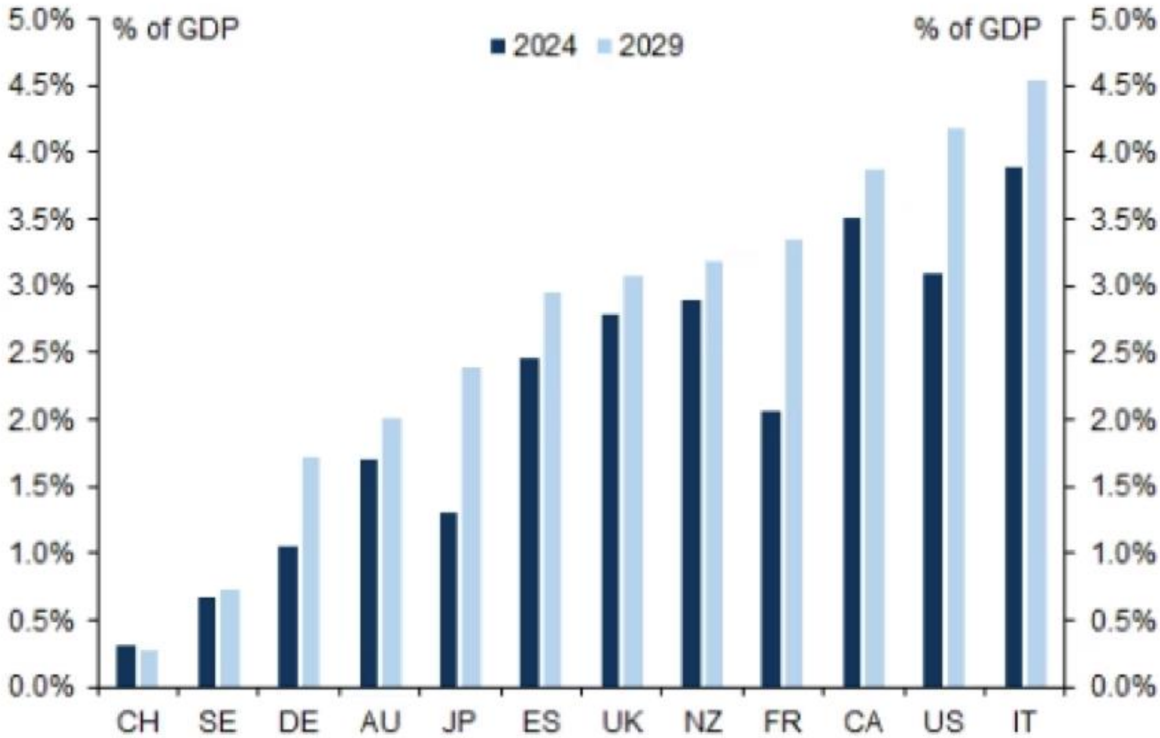
If the Fed is cutting because growth is slowing, longer-term yields would likely follow as investors seek the safety of 10-year U.S. Treasury bonds, driving yields lower and prices higher. However, if the economy avoids recession and lower rates fuel inflation, investors may demand higher yields to compensate for the risk.

Fiscal strain and political pressure complicate policy.

A recent University of Chicago survey found that a significant loss of Federal Reserve independence would sharply increase both the nominal cost of U.S. government borrowing and the risk premium on long-term debt. This challenge is not unique to the United States. Interest costs across the G10 are expected to rise as markets lose confidence in governments and central banks to manage fiscal and monetary discipline effectively.

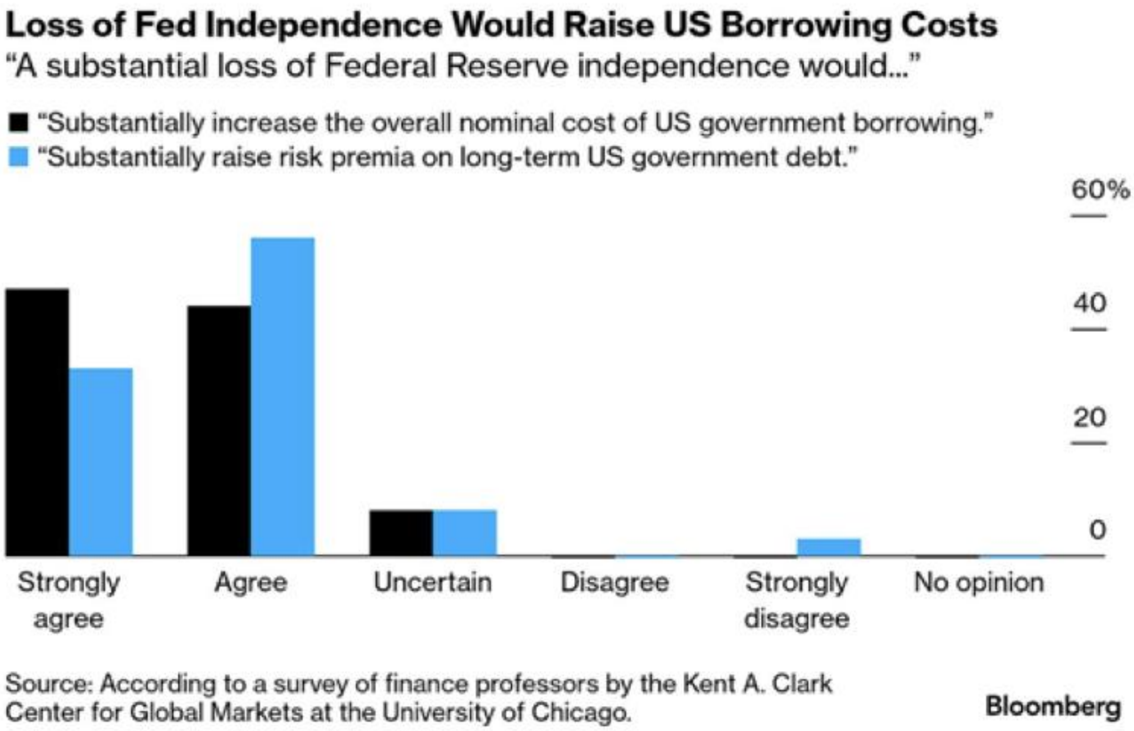
Exhibit 5: Interest costs are set to increase across G10

Interest Costs (%GDP)



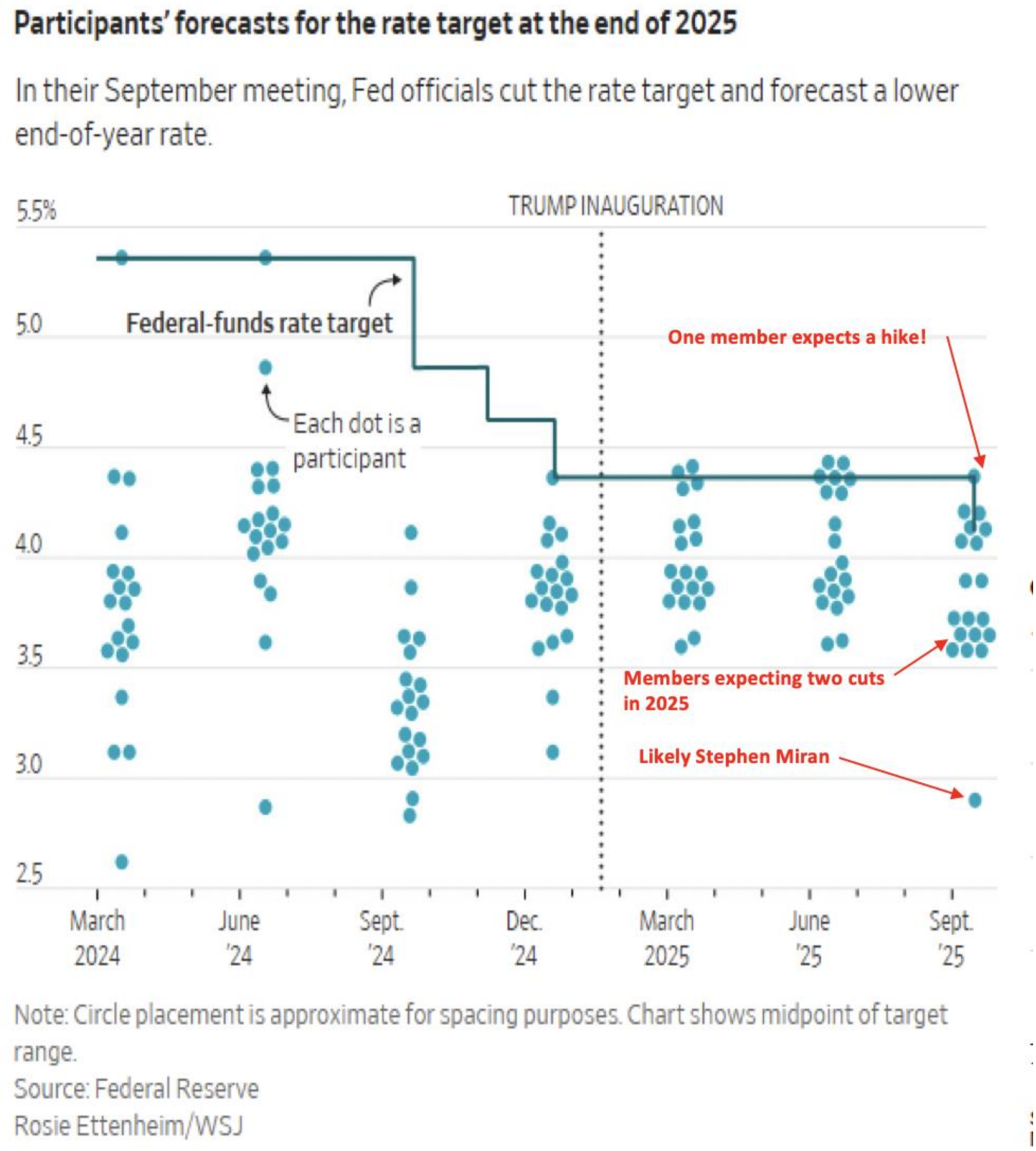
Source: Goldman Sachs Global Investment Research, IMF, Bloomberg, Goldman Sachs FICC and Equities

Political pressure on the Fed to lower rates remains a clear concern for markets. A September Bloomberg News survey found that 71% of economists are somewhat or extremely worried that monetary policy decisions next year could be heavily influenced by political loyalties. This fear has contributed to the rally in gold prices, as investors hedge against the potential erosion of central bank independence and the associated risks of future inflation and currency debasement.



More rate cuts on the horizon

We were somewhat encouraged by the dot plot released after last month's FOMC meeting. Rather than showing greater division, most voting members projected only one or two additional rate cuts by year-end. Outliers included one hawkish member expecting a rate hike and another forecasting the federal funds rate to fall below 3%, a view we believe is likely attributed to recent Trump appointee Stephen Miran.



The lack of broader support for these extremes is a positive sign for Fed independence and suggests it may be more resilient to political influence than feared. The fact that gold experienced only a brief pullback following this news reinforces our view that concerns over government debt and central bank credibility are global issues, not limited to the United States.

Productivity growth could ease debt pressures.

What could ultimately bail governments out is productivity growth that keeps economies expanding without reigniting inflation. In other words, countries could grow their way out of debt. This is the politically preferred path to debt stabilization, though it is rarely achieved.

If the enthusiasm surrounding artificial intelligence translates into real productivity gains, it is possible that economic growth could outpace the rise in government debt. However, it is still early. Bloomberg's Cameron Crise notes that U.S. productivity growth has been unremarkable so far. The Wall Street Journal's Greg Ip offers a more optimistic view, suggesting that recent strength in GDP alongside weaker payrolls could signal the beginnings of a productivity revival.

Whether AI deserves credit for this remains uncertain. A best-case scenario could produce widespread prosperity, while a darker outcome could bring severe disruption. In such an environment, riskier assets could face headwinds.

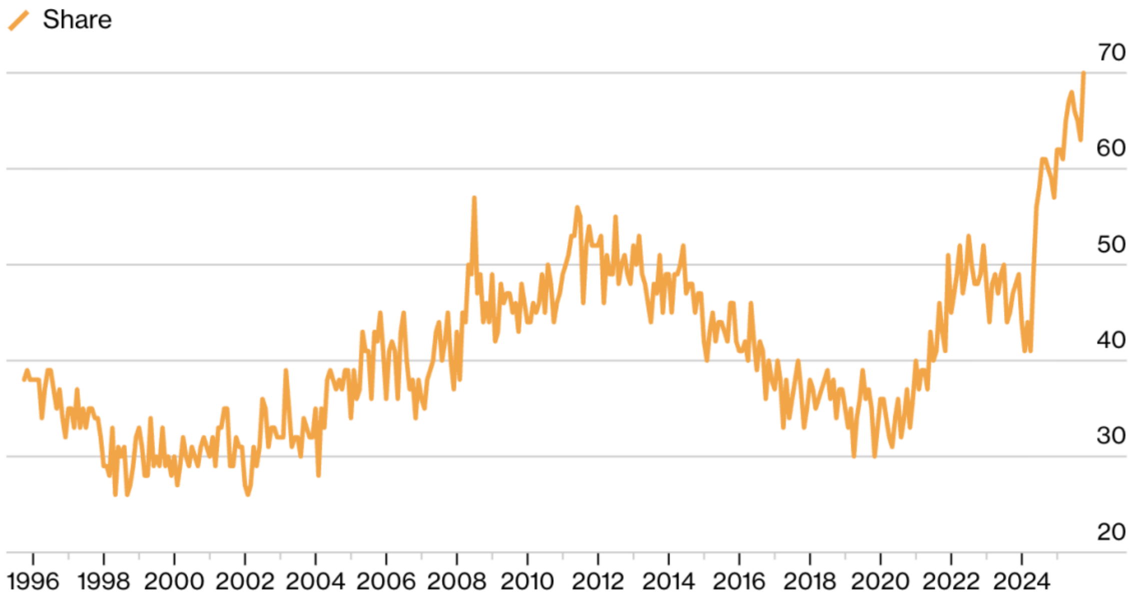
Consumer sentiment weakens as inflation persists.

In the short term, the Federal Reserve faces the challenge of balancing inflation risks against slowing employment and economic growth. Consumer sentiment has cooled, with the University of Michigan index falling to a four-month low and long-term inflation expectations (5- to 10-year) rising to 3.9%.

Stanford economists note that consumer sentiment has not followed traditional economic indicators higher, likely because inflation-adjusted income has failed to keep pace with prices. The University of Michigan reports that consumers expect this trend to persist over the next one to two years.

Cost of Living Fear

Consumers anticipate that inflation-adjusted income will fail to keep up with prices during next 1-2 years



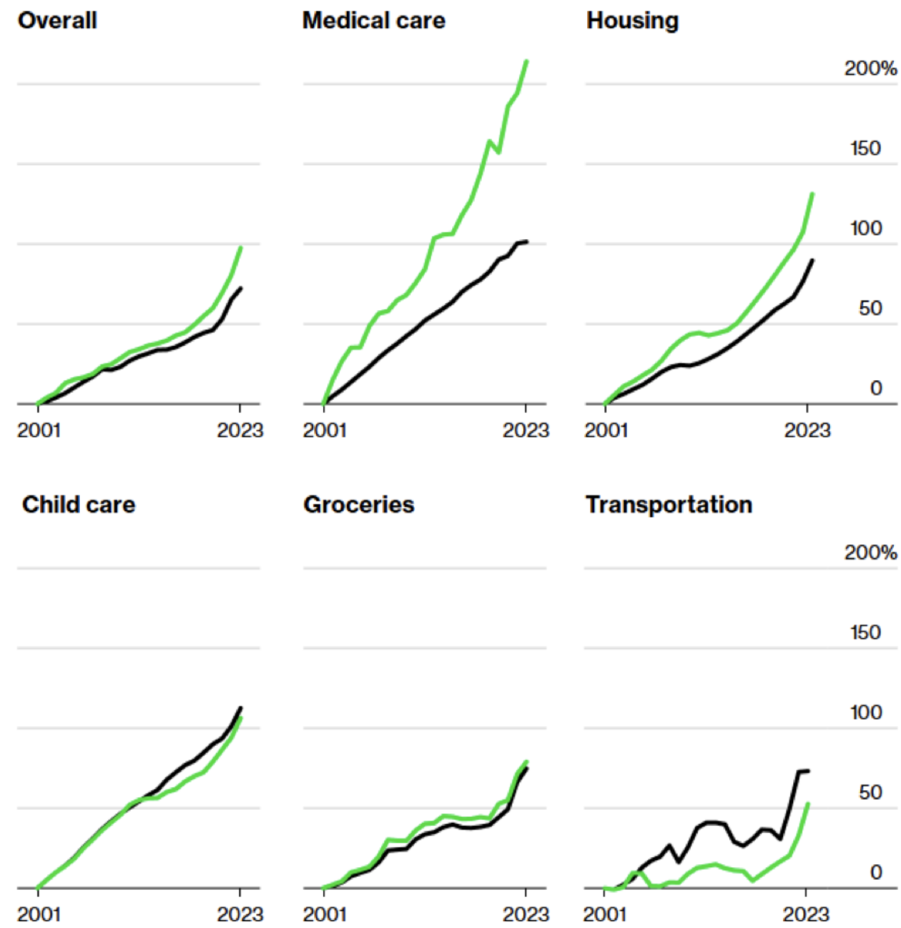
Source: University of Michigan

Gene Ludwig, former U.S. Comptroller of the Currency under President Bill Clinton, argues that the Consumer Price Index understates the true cost of living since it includes items beyond the reach of the average American. Using his alternative measure, prices have risen 1.3 times faster than reported since 2001.

How the "True Living Cost" Compares to the Consumer Price Index

Change since 2001

TLC CPI



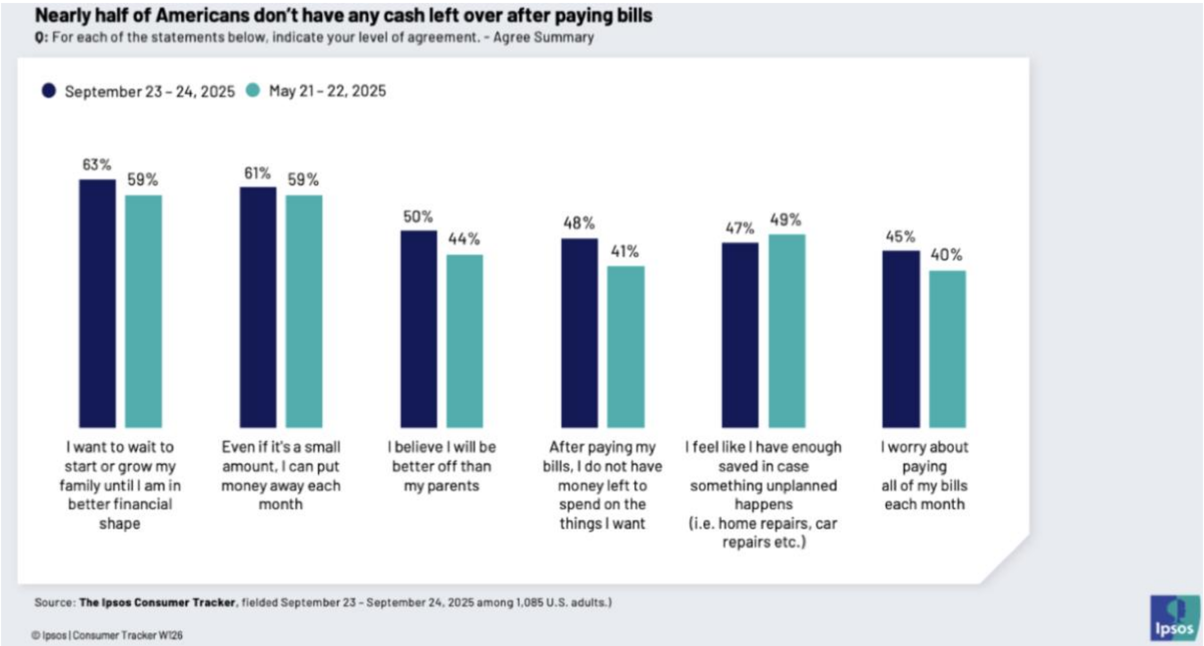
Sources: Ludwig Institute of Shared Economic Prosperity, Lisep calculations based on US Bureau of Labor Statistics data
Note: Price chart compares CPI categories to their closest comparable TLC categories

The job market is another concern. Newcomers are finding it harder to secure employment, with the unemployment rate for this group at 11%. Young workers are particularly affected, as the jobless rate for Americans aged 16 to 24 reached 10.5% in August, the highest in a decade. The positive news is that layoffs remain low, resulting in a "low-hire, low-fire" environment where many workers are underemployed or working part-time involuntarily.

A two-speed economy is taking shape.

As a result, a two-speed economy has emerged, with higher-income workers driving most of the growth while lower-income and underemployed workers struggle to keep pace. The top [10% of earners now account for roughly 50% of all consumer spending](), while the bottom 60% account for only about 20%.

Ipsos finds that nearly half of workers have no disposable income left after paying their bills. Morning Consult's Consumer Sentiment Index, when broken down by income, shows that [sentiment among workers earning under $50,000 per year trails]() far behind those earning over $100,000, highlighting the widening economic divide.

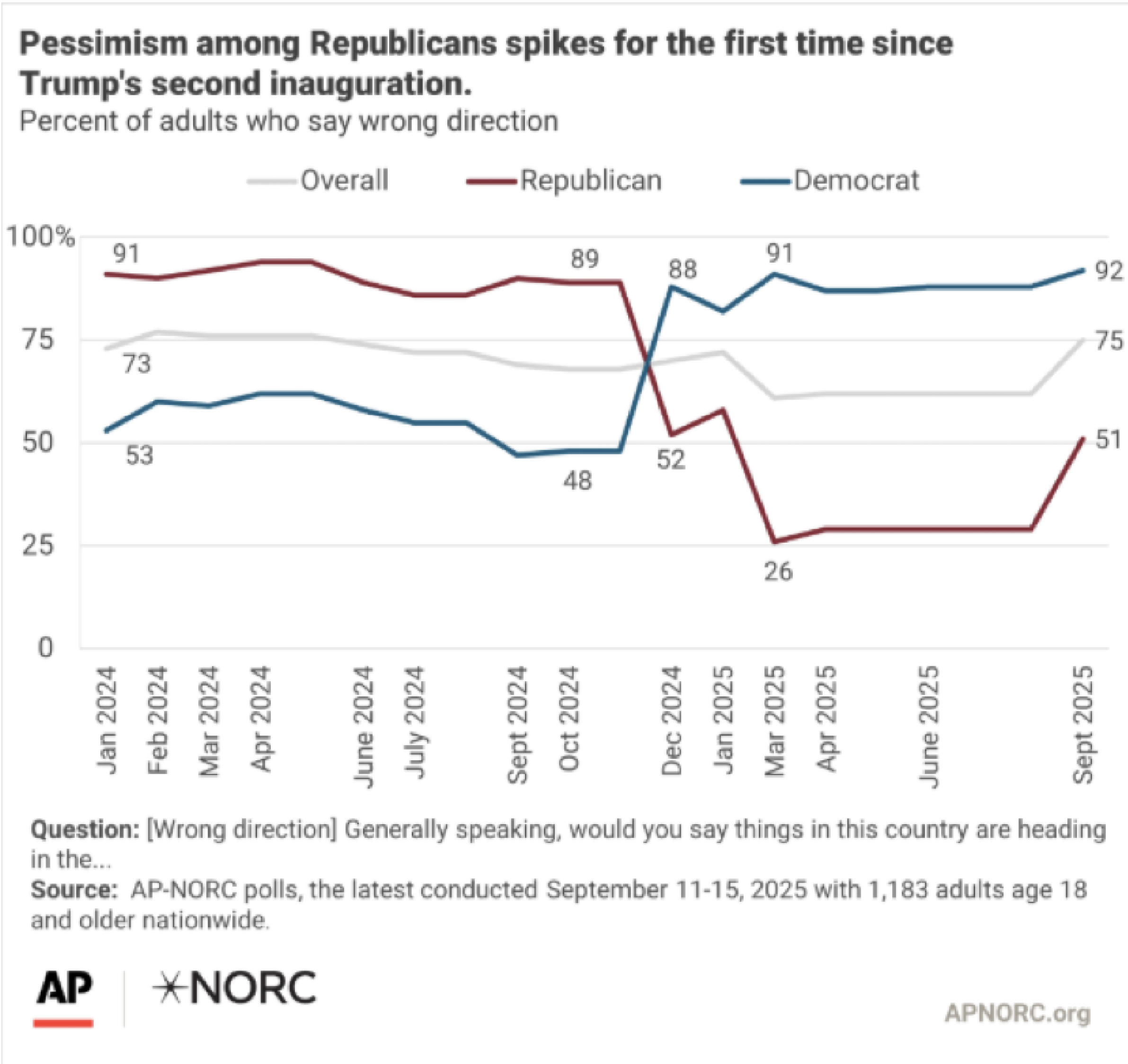


Trump's economic trilemma adds complexity to market dynamics

A recent *Business Insider* article argues that President Trump faces an economic trilemma: trying to boost U.S. manufacturing, reduce immigration, and keep prices stable all at once. Some xxperts suggest it may be possible to achieve two of these goals, but not all three.

Additional objectives make the challenge even greater. Trump aims to increase government revenue while cutting taxes. Tariffs and inflation function as hidden taxes, and Americans are likely to experience both. He also appears motivated to increase his personal wealth, a goal we view as highly achievable in the short term.

Trump's ability to advance his agenda through Congress depends largely on his popularity and the strength of the economy. Pessimism among Republicans has risen, and special elections in competitive districts in 2025 have [largely swung toward Democrats]().



Still, Republicans maintain an advantage with voters on three major issues: crime, immigration, and the economy. For markets, as long as Trump continues to push his broader economic agenda forward, the so-called "debasement trade" — driven by gold, bitcoin, and technology stocks — could have further to run. Bloomberg describes this as the market's new reaction pattern whenever negative macroeconomic headlines emerge.

Bond yields and the dollar remain key indicators.

Two indicators investors can monitor to gauge the success of President Trump's economic agenda in the short term are 10-year Treasury yields and the strength of the U.S. dollar. Even if the Federal Reserve is pressured into cutting rates more aggressively than inflation would justify, the market ultimately determines where long-term yields settle.

Bloomberg notes that 10-year yields surged last year even as the Fed was cutting rates. So far in 2025, the Bloomberg U.S. Economic Surprise Index has risen sharply, yet 10-year yields have remained subdued. Foreign central banks are no longer the dominant force in the Treasury market. Private foreign institutions have become the marginal suppliers of foreign capital, and unlike governments, these investors are far more sensitive to return and yield considerations.

U.S. Economic Surprise Index Has Surged - Will 10-Year Yields Follow?

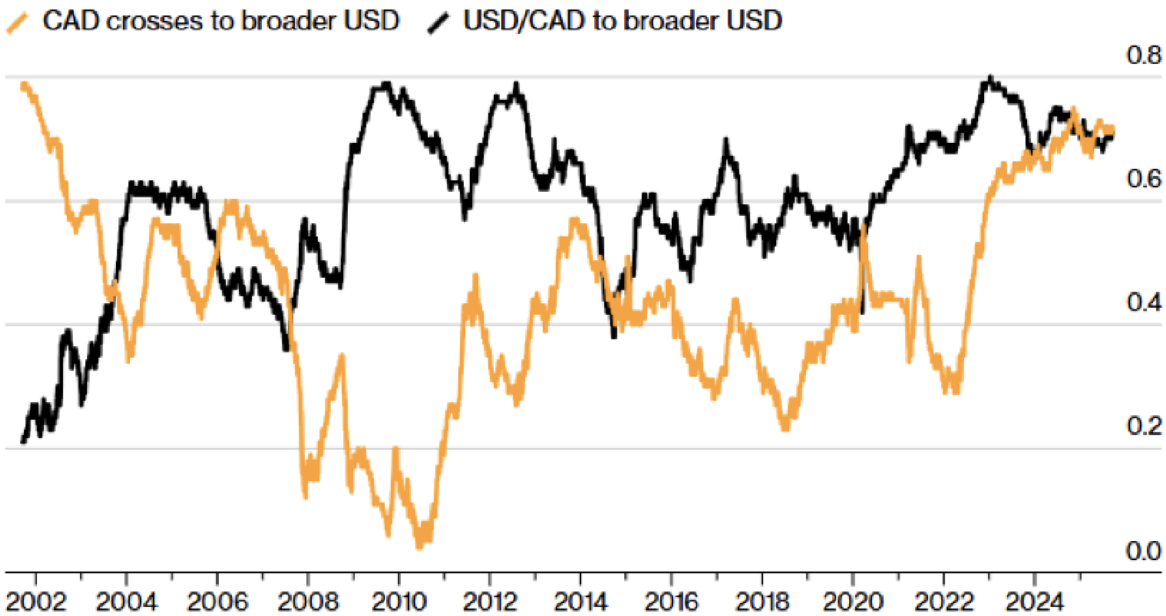
In the short term, the long-term yields might decline as the Fed cuts rates, but the risk the yield curve steepens with long term rates rising is still very much a risk for investors going forward. There is just too much supply given the risk of declining demand.

The Federal Reserve could step in as a buyer of last resort, purchasing longer-term Treasury bonds to suppress yields through quantitative easing. However, this would increase the money supply and add pressure to the U.S. dollar. The dollar is already having its weakest year in decades, with underperformance most notable against European currencies. Most of the pressure on the greenback has come from foreign investors hedging their U.S. dollar assets rather than selling outright.

The Canadian dollar has also strengthened against the U.S. dollar, though less than other G10 currencies. The loonie has appreciated just over 3% year-to-date, as the two currencies have become increasingly correlated. Volatility in the USD/CAD pair is lower than in most other major currencies. Despite this, Bloomberg reports that hedge funds have increased their bearish positions on the loonie.

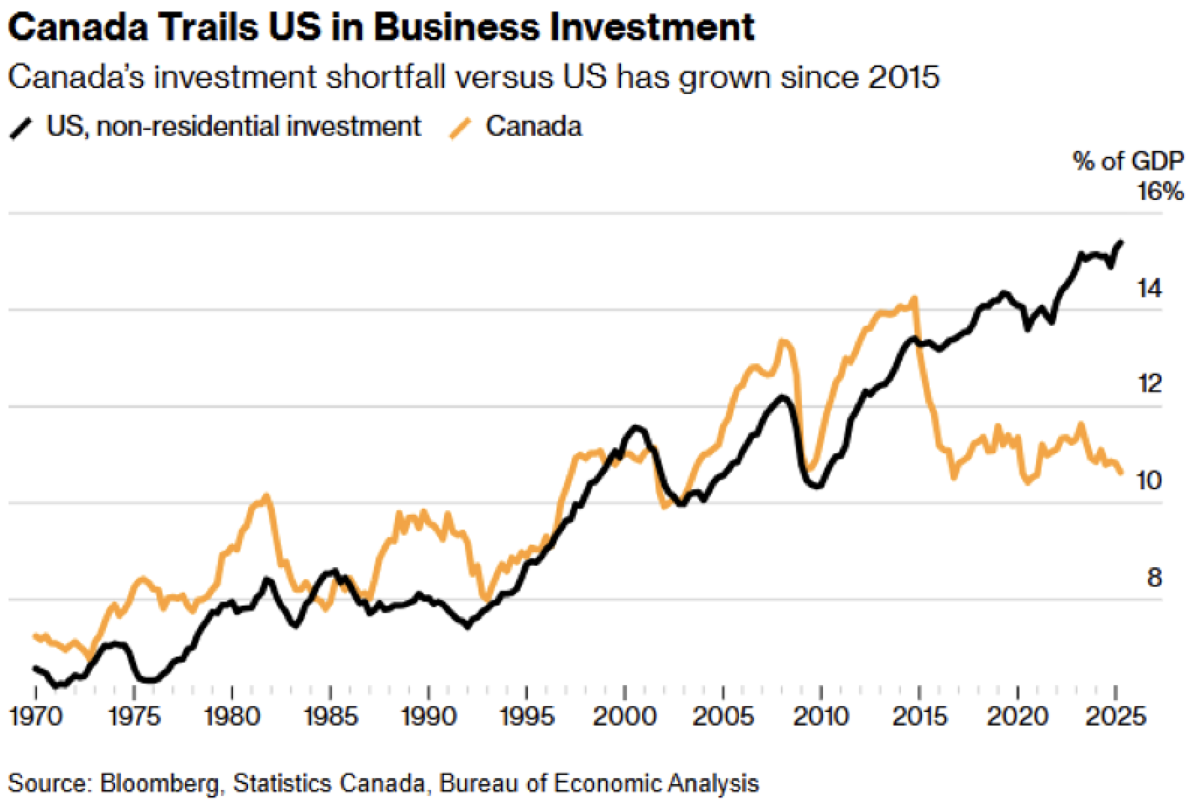
Loonie's Linkage to US Currency Growing Tighter

One year rolling correlation of daily returns for:



Source: RBC Capital Markets, Bloomberg

What do hedge funds see that worries them? Canadian economic growth has been generally weak and appears to be getting weaker. Population growth has stalled, and Canada continues to be a consistent underperformer in productivity. Business investment in Canada has trailed the United States since 2015.



The Canadian dollar could find some support if the Bank of Canada signals an end to its easing cycle. Even better would be a favourable trade agreement with the United States, or any deal that restores confidence. The current uncertain trade environment continues to make it difficult for Canada to attract investment capital.

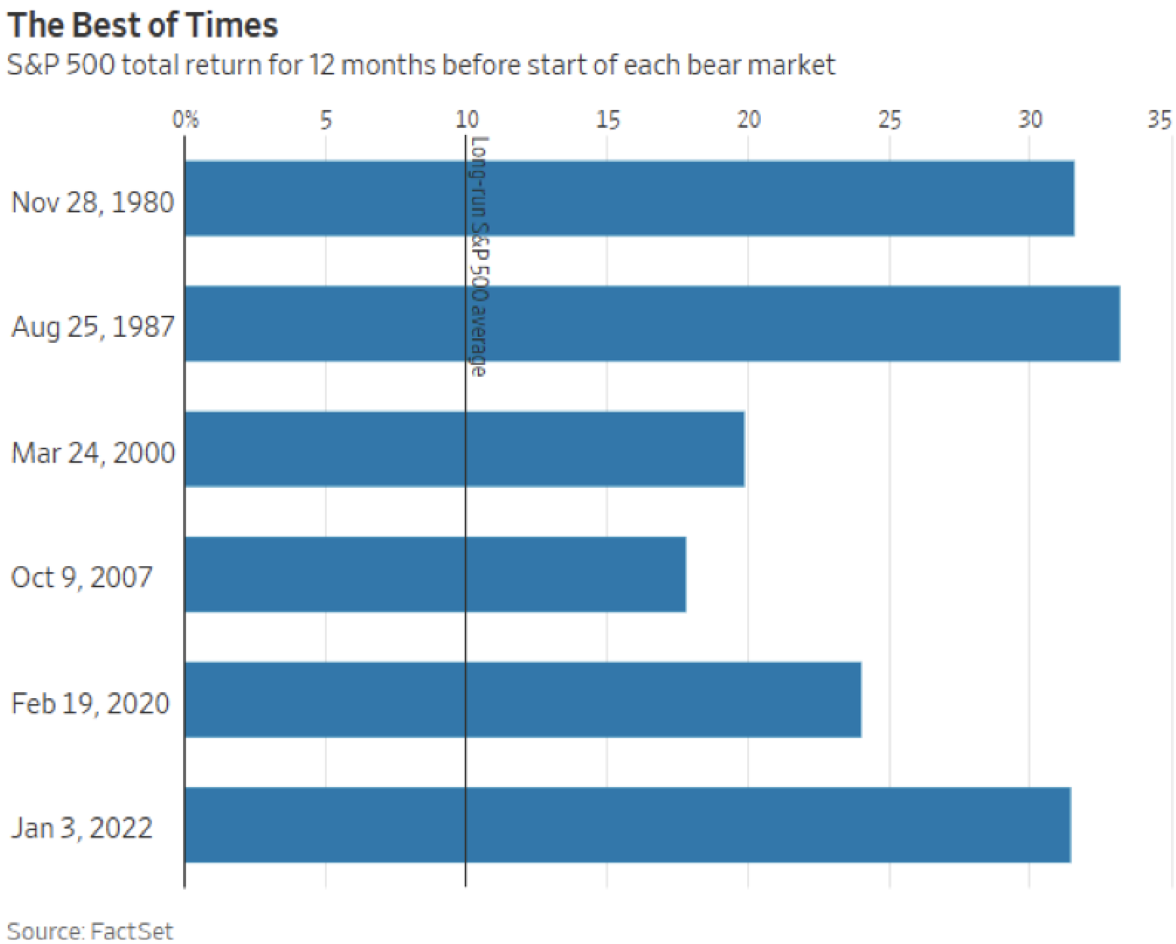
Gold reflects rising concern, not euphoria.

For those inclined to worry, this market provides no shortage of reasons. The recent rally in gold reflects growing concerns about currency debasement, unsustainable global debt, and the erosion of central bank independence, all of which have made the yellow metal increasingly attractive.

Productivity growth appears to be the most effective long-term solution to the global debt problem, allowing economies to expand without triggering inflation. Artificial intelligence could help deliver that outcome, offering hope that efficiency gains will eventually materialize. From this perspective, it may be logical that U.S. equities remain driven by technology and AI, with a more dovish Federal Reserve providing additional support.

What could derail this optimism? Either an overheating economy that pushes inflation higher or a weakening job market that begins to weigh on consumer spending and growth. Anything in between should allow the rally to continue.

Every bull market eventually ends, but timing that turn is notoriously difficult. The Wall Street Journal notes that 12-month returns for the S&P 500 prior to bear markets have historically been quite strong. Selling too early can be costly, especially since the fourth quarter has often been the market's best-performing period.



Investors should continue to watch 10-year yields and the U.S. dollar for signs of stress. Credit spreads are also worth monitoring, as corporate credit has remained resilient so far. Any sign of deterioration could be an early warning. Gold may already be signaling caution; the challenge is knowing when to listen.